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FM AMEMBASSY NEW DELHI
TO RUEHC/SECSTATE WASHDC 5320
INFO RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE
RUCPDOG/DEPT OF COMMERCE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS SECTION 01 OF 02 NEW DELHI 000241

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E.O. 12958: N/A
TAGS: [ECON](#) [EFIN](#) [EINV](#) [EIND](#) [KCRM](#) [KCOR](#) [IN](#)

SUBJECT: SATYAM PUTS THE SPOTLIGHT ON CORPORATE GOVERNANCE IN INDIA

¶1. (SBU) Summary: Indian government and industry leaders are working to make the fraud and failure of corporate governance at Satyam appear to be an isolated incident. However, industry insiders and legal experts view Satyam as indicative of widespread lack of corporate governance especially in companies that are family owned. Regulatory changes are coming, as well changes in the way industry governs itself, but the question remains, will good corporate governance become the norm for those companies that have so far only paid it lip service or will it be business as usual once domestic and world attention fades over Satyam? End Summary.

Corporate governance prior to Satyam

¶2. (SBU) Several legal experts told Econoff that, prior to the Satyam debacle, corporate governance for many Indian companies was an afterthought, especially for small to mid-sized family owned companies private or publicly held. This was believed not to be true for the top tier publicly traded companies until Satyam raised the specter that even these blue chip companies might not be following best practices. According to these legal experts, it is not difficult for companies to adhere to the legal formalities of corporate governance as required by the Companies Act or Clause 49 of the Listing Agreement, if they are publicly traded, while internally governing themselves as they see fit. The hope now is that, since Satyam has put the spotlight on corporate governance, better practices will become the norm for those companies that have paid them little attention in the past.

Expected changes in the law

¶3. (U) The consensus among these legal experts, the Director and Head of the Financial Sector and Corporate Laws at the Federation of Indian Chambers of Commerce and Industry (FICCI), and the Head of Policy for the Confederation of Indian Industry (CII), is that significant regulatory and statutory changes in the law are likely to occur as a result of Satyam. The Securities Exchange Board of India (SEBI) is reportedly working on a concept paper to revise Clause 49 of the Corporate Listing Agreement to give independent directors more powers and strengthen disclosure norms, and the new Companies Bill submitted in October of 2008 to Parliament is also likely to undergo changes to address the problems brought to light by the fraud at Satyam. The primary reason for the expected changes is recognition in all sectors that the perception that Indian companies engage in good corporate governance is critical to regaining the confidence of domestic and foreign investors.

¶4. (SBU) A complicating problem is that, because current laws are not enforced, some believe new laws will meet the same fate. Courts in India are woefully overburdened and cases often take years to be concluded. Added to this is the potential that corruption may influence the outcome of litigation. At a recent conference on economics, lawlessness and justice, Montek Singh Ahluwalia, Deputy Chairman of the Planning Commission, among others, openly

acknowledged both corruption and the overwhelmed judicial system as a deterrent to effective corporate governance in India.

15. (SBU) In Satyam's case, fast action may actually occur because of domestic and world attention, and a prevailing view among many in India that an example of the company must be made. The fear is that to do otherwise would discourage investment in an already uncertain market because of the recent Mumbai terrorist attacks and the global economic slowdown. The concern is, however, that, even with strong criminal and civil action against those responsible for wrongdoing or negligence in the Satyam debacle, similar expeditious action is unlikely to result in similar cases in the future, especially if they are on a smaller scale. One potential solution on the table is the creation of separate courts to hear and quickly dispatch cases involving Clause 49 and/or the Companies Act. Whether such a system will be created remains to be seen but it would be a good indicator that India intends to tackle its corporate governance problem.

Industry self governance

16. (U) CII has created a special task force comprised of industry heavy weights as a direct response to the corporate governance issues raised by Satyam. Naresh Chandra, former Cabinet Secretary and Indian ambassador to the U.S., heads the task force and its findings are expected to be released in forty-five to sixty days. One of the primary reasons the task force was formed is to show that the concerned parties in India are acting quickly to cut the Satyam cancer from the corporate system and prevent it from recurring.

17. (SBU) Indian industry is worried, however, about too stringent changes in the law. Industry reps told Econoff that they do not

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support Sarbanes-Oxley-like legislation because it will raise the costs of doing business to an unacceptable level. They noted that a previous committee headed by Naresh Chandra, formed in 2002 at the behest of government to address similar corporate governance issues recommended against adopting Sarbanes-Oxley provisions such as the creation of the Public Company Accounting Oversight Board (PCAOB) that in the U.S. regulates and disciplines auditors of public companies. In addition, a refrain Econoff heard more than once was that good corporate governance is a moral issue. For it to truly take hold, industry must create an environment where good behavior is rewarded and sets the standard by example.

18. Comment: (SBU) Despite public statements of support for stronger corporate governance by senior government official and industry leaders, good corporate governance in India is not the norm. The hope is, however, that Satyam will be the catalyst for positive change. For this reason, new laws and practices regarding corporate governance are likely to be promulgated soon. However, their success will depend on active enforcement by both the government and private sector.

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